BUSINESS RESOURCE CENTRE

ENTREPRENEURS HANDBOOK

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Starting a Hardware Business

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INTRODUCTION

According to the 1985 financial survey of the Canadian Retail Hardware Association, the hardware industry in Canada is fairly stable. The sales volume in the prairie provinces averages over $481,000 per store per year, but the range is broad from $157,000 sales volume for a small business to $976,000 for a large one. Gross profits are decreasing and are now at a level of 27.78% of sales, but there is a corresponding increase in expenses, to 26.75%. The market is competitive, especially because the business is broadly defined and the hardware retailer has to compete with other hardware stores, department stores and speciality stores, depending on the mechandise.[1]

In Manitoba there are 155 retail hardware stores. In Winnipeg there are 24 retail hardware stores and 33 wholesale and manufacturing listed in the Yellow Pages. Stores outside Winnipeg have a broad assortment including hardware, groceries, clothes, footwear, radios and televisions.

Before starting a hardware store many things have to be considered. Only after you have carefully assessed what is required to properly set up the operation and have developed a workable business plan covering all relevant factors is it time to open the doors. But also, an ongoing evaluation and an ability to adjust quickly to the changing environment will enable your business to achieve its planned profitability.

In this handbook some of the key areas are identified where management effort must be concentrated. Any successful business requires many diverse skills, such as salesmanship, accounting, purchasing, advertising and financial management. Your ability to work through and develop these areas will directly affect the future success of the operation.

[1] Source: 1985 Financial Survey - Retail Hardware Stores.

Should you require further assistance, the Manitoba Dept. of Industry, Trade and Tourism has a broad range of services and publications available to assist small business. This brochure should be read in conjunction with other volumes in this series such as "Service Business Plan", "Small Business Finance Plan", "Retail Business Plan, "Marketing".

Once a decision has been made to start a retail operation, one must choose amoung (1) buying an existing business (2) franchising and (3) setting up a new business.

(1) Buying an existing retail business:

Advantages:

- you can start your business right away
- you have the possibility of having an experienced staff
- an existing business has a proven business history
- the financing may be easier when based on past performance

Disadvantages:

- the location is fixed
- facilities, image and business policies of an existing business can be difficult to change and changes can mean additional costs
- there may be a goodwill charge

(2) Franchising:

Advantages:

- established image
- formula for operating
- assistance in decision making, financing, management, etc.

Disadvantages:

- formulae restrict individuality
- possible constraints in purchasing and other areas
- cost of franchise may be prohibitive

(3) Starting a new retail business:

Advantages:

- freedom of choice of location
- set your own style of business
- develop at your own rate

Disadvantages:

- there will be a start-up time where cash out flows exceed cash inflows
- you have to establish your own clientele
- the risks and uncertainties are higher
- the lack of a proven past makes it harder to get financial support

BUYING AN EXISTING STORE

If you purchase an existing store, you have three essential steps to take, all involving considerable thought and investigation:

1. Find available opportunities;
2. Evaluate opportunities in detail;
3. Handle the transaction properly.

1. Finding available opportunities:

There are several channels for uncovering business opportunities including:

- realtors, especially those specializing in business opportunities
- newspaper ads
- trade sources (such as supplies, distributors and manufacturers), trade publications and trade associations
- Chambers of Commerce

2. Evaluating the opportunity:

This is a crucial stage. The buyer faces the problem of determining whether the business is viable and what would be a fair price. This investigation should cover the reasons for selling, the profit picture, assets, and liabilities.

Reasons for selling: The reason might be poor health or retirement, but also might be declining business, changes in the character of the neighborhood, lack of competitive strength, new competition, obsolete products, highway construction or rerouting, an expiring lease of franchise, obsolete facilities, inability to collect accounts receivable or problems with creditors.

Profits, sales and expense: The determining factor in evaluating the business is its future profit potential. To estimate the potential earning power of the business, you should find out about past profits, sales and operating ratios and, in addition, attempt to project sales and profits for the next year or two. Analyze the owner's income from the business for each of the past three to five years and also compare them with trade averages. The records of past performance can give you this information. From the sales and operating data, you should attempt to project sales and profits and a cash budget for at least 12 months. Exhibit 1 can help you in setting this up. This analysis should indicate the potential of the business. If it is not profitable, you should determine whether or not your management can improve the situation. This may be the point in the analysis to ask for advice. Manitoba Department of Industry, Trade and Trouism has a broad range of services and publications available to assist small business.

Assets and liabilities: Closely investigate the assets and liabilities. A physical count of the inventory should be taken to determine a realistic price. It should also be examined for age, quality, salesability, style and condition. Is the inventory in line with what the buyer of the business would like to sell? Is it in character with the neighbourhood? Determine the physical condition of the building, fixtures, and facilities. If the accounts receivable are included in the price they should be studied closely. A spot check of the records will roughly indicate their age. Accounts receivables should be aged by period of time outstanding. The longer the period, the less the value of the account. Consider the lease: Is it transferable to you? How long does it run? What are the terms?

Try to find out if the business has a good reputation and established, satisfied clientele. Concerning trained personnel, will key employees continue to work for the firm under new management? If they are lost, how adversely would this affect the business? Liabilities may be extensive and hidden, so help of an accountant is usually necessary.

3. Handling the final transaction:

You should get a lawyer's help in closing the deal and conveying clear title to the business and property. The question of what is a fair price provides the biggest problem when a business is to change hands. The buying price is usually based on the value of tangible assets, plus an estimated value for intangibles, or "goodwill". How to set these values almost always causes controversy since buyer and seller look at the business from vastly different view points. Exhibit 2 gives an example of a formula for arriving at a price for a business. Since all businesses are different, the formula cannot cover all types, but can only be a rough guideline to point out some of the key considerations.

FRANCHISING

Many hardware stores are franchise operations. There are advantages and disadvantages to operating a franchise outlet.

Franchises offer established images and formulas and may thereby improve chances of achieving initial success. Assistance is offered in choosing a location, financing the building, training, accounting, inventory selection and general management. The franchisee is less apt to make costly errors since the franchisor's established formula is there to follow. Unfortunately, that same formula may be somewhat restricting as the business begins to develop.

For example, the franchisee may not be able to expand the business by opening another outlet as an independent retailer can do. As well, the franchisee may not be allowed to purchase merchandise from other than certain designated suppliers, even though a better deal might be available elsewhere.

The franchisee, of course, pays for the rights and advice provided. Sometimes you buy a formula within a certain price range (for example, $30,000), and/or pay a percentage of your sales. It is important to thoroughly examine the franchise agreement in order to identify all the costs associated with the franchise, and the benefits to be received for the franchise fee.

There are a number of other points to consider in the agreement:

Who decides on the location?

Does a building have to be constructed?

Do fixtures and merchandise have to be purchased from a specific supplier?

Is your territory protected? For how long?

Do you have the right to set or adjust prices?

What will your payments terms be?

What other controls exist (over advertising, hours of business, etc.)?

Review any franchise agreement with your lawyer for terms and conditions before agreeing to take the franchise.

SETTING UP A NEW BUSINESS (NOT A FRANCHISE)

The steps involved in setting up a new business are similar to those followed in buying an existing store:

1. Search for opportunites
2. Thoroughly analyze each appealing option
3. Give due consideration to each detail of the transaction.

1. Searching for opportunites:

If you are prepared to construct a new building, look for land that is for sale. Otherwise, look at the market for buildings. It may be preferrable to limit your search to buildings that are/were occupied by retail or wholesale businesses that are similar to the hardware business; in this way you may avoid costly renovations for inventory storage and displays.

Inquires can be made through realtors, newspapers, trade sources and Chambers of Commerce.

2. Analayzing options:

Whether buying land only or land and a building, follow the same steps in evaluating each opportunity as outlined earlier in "Buying an existing store", Step 2. It is important to thoroughly analyze each option which has appeal. Estimate all costs involved - purchase price, building and/or renovating costs, operating expenses for each location - and try to predict reasonable levels of sales as well as growth patterns in the area's population.

3. Consider the transaction carefully:

Make all details explicit; it is imperative that all people involved in the deal have the same understanding of the particulars in the transaction.

Consult a lawyer before signing so that you understand your legal obligation.

LEGAL CONSIDERATIONS

In starting a hardware store, thought must be given to the business structure your operations will assume. The more common alternatives include sole proprietorship, partnership and incorporation.

Each of these business structures has its own distinct advantages and disadvantages. Factors such as the ease and cost of organization, financing, management risk, limitations of liability and tax considerations will all influence your decision regarding the business structure most suited to your trade.

As a retailer, you will be required to register your business name, obtain a provincial sales tax number, an employer number and register with the Workers' Compensation Board. You must comply with all tax regulations and employer regulations. The Business Resource Centre has produced a handbook "Starting a Small Business in Manitoba", which summarizes many of your responsibilites in areas such as licensing, permits, taxes, etc.

It is also essential that you determine your insurance needs prior to starting your business venture. The main types of insurance to consider are:

General Insurance - most often this type of coverage includes insurance on the assets of the business, liability insurance on premises and vehicles, fire insurance, crime and vandalism insurance and business interruption insurance.

Life Insurance - usually this coverage is placed on the lives of the owners (often partners will purchase life insurance on each other's life in order to ensure the continued survival of the business).

Worker's Compensation - this is required by Manitoba law for reimbursing employees injured on the job for any loss of wages suffered as a result of such an injury.

Information and advice concerning these matters can be obtained by contacting your nearest Business Resource Centre located on the 6th Floor, 155 Carlton.

MARKETING

It is unfortunate, but many independent businesses are so busy coping with the day-to-day details of operation that they have little time to contemplate the future.

Businesses have to take action to put their product in the hands of potential customers. Activites undertaken to do so are part of the marketing function, and they include pricing, distributing, advertising, displaying, packaging, store design and so on. These activites create a wide range of decisions which are more easily made if there is some overall direction or plan.

The four elements of market planning are:

1. Get to know your market; that is, understand:
   - the consumer
   - the competition
   - the environment

   Analysis of these three factors should yield an assessment of your potential market.
2. Set objectives and decide upon marketing strategy, which will be your guide for the near future.
3. Develop an action plan and implement your strategy by filling in the variables like price, promotion and place.
4. Evaluate and monitor the results. Financial records are helpful at this stage.

The "Marketing" brochure should also be read in conjunction with this section.

TYPE OF BUSINESS

Individuals in the industry state that the hardware retail business is a relatively stable business, with not many extreme ups and downs. However, many stores have closed recently.

The reason for this in many cases was a bad inventory position. In the hardware retail business, inventory rises easily. With high interest costs and low turnover (dropped in 1984 from 3.01 to 2.75 times), problems arise. Of course, in any business, nothing can replace experience, but in the hardware business experience is a key word. If possible, it might be advisable to work for someone else in a hardware store first, even if only for a few months. This will provide you with valuable insights into potential problems and pitfalls you may face when running your own store.

The hardware retailer not only sells hardware but also provides advice and service to the customer, who is often not well versed in this field. An important product sold is "problem solving". Personal interaction with the client is, therefore, not to be overlooked.

TYPE OF MARKET

The hardware business is highly competitive. For some products the market is very clear and price-sensitive. Most hardware stores have a diversified assortment. The type of competitors depends on the merchandise handled in the store.

The trading area of a hardware store differs from one outlet to another, depending on the location, as well as the depth and width of the product mix. However, the character of a hardware store is that of a neighborhood business.

Since the customer needs personal service and advice, a strong store loyality can be created. It is a differential advantage with regard to the competition if the personal treatment of the client is properly carried out.

The average Sales Volume of reporting stores decreased in 1984 by 5.9% compared to 1983. However, this is probably due to a different mix of stores participating rather than to an overall decrease in sales on a national basis.

Gross Profit increased by just over 2% and Expenses increased by approximately 1.3% compared to 1983. Net Income before Income Taxes showed a slight increase of .43%. Stock Turns fell from 3.01 x in 1983 to 2.75 x in 1984. This decrease in Turns was due, primarily, to the different mix in stores participating. The overall average Return on Investment has increased from 19.79% in 1983 to 20.15% in 1984. Some care should be taken when using the 1984 statistics for Retail Hardware Stores contained in the survey. The statistics were complied from the data supplied by 108 participating stores and this is a very small statistical base.

Exhibit 3 shows the seasonal pattern in sales for the prairie provinces and for Canada as a whole. There are two peaks during the year, in the spring and in December, while business is slow in January and February. The sales volume in a year ranges from $157,000 in a small store to $976,000 in a large store (in the prairie provinces).

INVENTORY

A hardware store can handle many different items. Some are basic for a hardware store; some are complementary; and some are only loosely related to the core business. The frequently occuring product groups, with their sales relative to total sales, are:

1985 NATIONAL AVERAGES

hardware	19.25%
housewares	12.06
sporting goods	6.23
paint and supplies	14.39
lawn and garden	9.72
tools	7.19
plumbing supplies	9.68
miscellaneous	8.17
	100.00%

(Source: 1985 Financial Survey; Canadian Retail Hardware Association)

PRODUCTION CONSIDERATIONS

Turnover of stock is vital for the success of the business. Inventory turnover ratio is a tool which can help with inventory management. The ratio is defined as follows:

$$\text{Inventory Turnover Ratio} = \frac{\text{Sales}}{\text{Retail Value of Average Inventory}}$$

$$\text{Average Inventory} = \frac{\text{Inventory January 1}^{st} + \text{Inventory at Month End for Each Month}}{13}$$

For example, assume that the sales for year are $350,000 with an average inventory of $120,000. Then the inventory turnover ratio would be ($350,000 ÷ $120,000) 2.9.

The turnover rate depends, of course, on the type of goods sold. The assortment of a hardware store can be grouped into three categories.

1) A - Category Products: Basic Goods

The products in this category can be considered as basic hardware goods like nails, pins, tools, etc. About 20% of the total items handled belong to this category, representing 70% of the sales. The market for these items is very clear and the clients are very price-sensitive. The price, therefore, must be competitive. You will also lose customers to competitors if you run out of stock in the items. An overstock in these items is better than a stock-out since demand is stable and does not change over a longer period. A turnover of six to seven is believed to be necessary. The purchasing procedure of the A-category items can be standardized via a minimum inventory level and an optimal ordering quantity system.

2) B - Category Products: Complementary Goods

The products in this category can be considered complementary goods. If a client buys, for example, paint and brushes, the complementary items to these basic goods are cleaners, solvents and absorbers. As opposed to the A-category products, the B-category products are less competitive. The customer is far less price-sensitive concerning these items and does not compare prices with those of competitors. The markup, therefore, can sometimes be as high as 60%.

As with the A-category items, you should have a supply of B items in stock although ordering can be done quickly.

Advice and service are important. Since the items are of a complementary nature, package selling is possible and profitable. For instance a customer that comes into the store to purchase paint may pick up supporting items such as brushes, edgers, rollers etc. So it is suggested that primary products need to be accented by supporting items. The turnover for B items should be approximately four.

3) C - Category products: Peripheral goods

This category contains all other products the retailer thinks can be sold. It is broadly defined. The items can be sporting goods, toys, electric appliances, yard furniture and so on. The goods are very attractive to sell because the price can be set at any level as long as it is competitive; this implies a respectable markup. Also, traffic can be increased by adding these items to the product line. However, this is only one side of the coin. The reverse side is that, because of the attractiveness of these goods, you may lose sight of the inventory costs. Many stores have encountered trouble because of too much inventory in these C items. Inventory control on these items is absolutely necessary. Feeling for the market is needed to successfully sell the C items. Stock should turn over once per year.

When starting a hardware retail store without experience, it may be best to start with the items from the A and B categories. Until you get a feeling for the business it seems better not to get too involved with the C category item.

SUPPLIERS

Selection of suppliers is another decision. If you own a franchise operation, you might be tied to the franchisor or the suppliers the franchisor selected. Otherwise, for the A and B category items, you need reliable suppliers who can deliver frequently and, if necessary, in a short period. For the C category you can choose any supplier, depending on the merchandise and conditions. Develop a good business relationship with your supplier in order to ensure good service. For some items you will have to deal with merchandisers, particularly with special items like books and magazines, and housewares. Some merchandisers deliver, stock the shelves, and price the items. They, of course, charge for their service, so you must trade-off the markup lost against the time you save, and the more accurate demand estimates provided.

INVENTORY CONTROL

Inventory control is one of the most important parts of the hardware retail business. Your objective with regard to inventory control is to minimize (1) lost sales and (2) inventory holding costs. The effectiveness of any inventory management system is highly contingent upon the records kept. Accurate records can provide a basis for developing demand estimates and for determining product mixes. One means of monitoring inventory is to maintain perpertual inventory records. Cards are kept for each item in the store, detailing purchases, sales and prices. Periodically one would physically count the items to verify these written records. This can be done especially with the C category items because inventory control is most important for them. For A and B category items it is necessary to ensure that they are in stock.

As stated earlier, inventory turnover is a tool which can help inventory management. While the turnover ratio for the basic hardware goods is suggested to be six, for the complementary goods four, and for the other items one, the average ratio of all goods in the store is suggested to be around four. Should your average turnover figure be lower, your inventory may be longer on the shelves than is desired. This may indicate that you are not offering the proper product mix, or that the projected market simply does not exist.

LOCATION

One of the most important decisions you must make is where to locate your store. The location can be a critical factor in determining the ultimate success or failure of the operation. In addition to the general question of whether to select a convenient location, possibly with high rent payments, or a less convenient one with lower rent, you will face several other kinds of choices:

- Will you locate in an important shopping district in a large city, or in the suburbs, or beyond the suburbs somewhere in the direction of what you hope will be the population trend?

- If you choose to go beyond present suburbs, will you pick a location in the central shopping district of small community?

- Will you locate in a shopping centre? Or on a well-travelled highway in the suburbs or country?

In choosing a location, bear in mind that most hardware stores must depend on other nearby retail and service outlets to attract customers. Since the average customer visits you only nine times per year, it is important not to locate your store off the beaten path. The density of traffic, both pedestrian and vehicular, passing a proposed site is another factor in determining the potential sales for the location. Seasonal fluctuations in traffic pattern and the surrounding population should also be assessed.

A survey could be useful for evaluating a location. You have to consider several factors. First, weigh the pros and cons of the potential - present and future - of the locations that are available. The next consideration is competition - existing and potential. Also, study the physical and environmental advantages and disadvantages of the locations. A good location should enable you to build a profitable business and it should have long-range growth possibilities.

In considering the present worth of the location you need a good idea of potential sales. You need to know:

(1) how many people live in the area
(2) their incomes and how much they spend in retail stores
(3) how much will be spent in hardware stores.

The growth potential will be harder to determine because it involves considerable judgement. You have to look into:

(1) population trends in the area
(2) the present per capita income.

The problem is the future direction of this income and population growth.

Statistics Canada provides statistical information about population on cities and towns, incomes, growth percentages and financial figures about the industry.

Closely related to the question of location is the question of lease obligations. The kind of lease you can get might well be a major factor in your choice of location. Since a lease covers some very complex situations, the tenant should protect his/her interest by having an attorney present during negotiations about the lease or at least by checking with an attorney before signing any agreement.

STORE DESIGN AND LAYOUT

In designing the store, be sure that all elements are carefully co-ordinated with the merchandise you are selling, but don't be afraid to use your imagination. The interior should help accent the merchandise and convey the image of a well-stocked store with an interior layout designed to encourage mobility throughout the premises. Such interior display and layout techniques should help to increase sales. If you sell yard furniture, for example, place it on artificial grass and put a lawn mower next to it. A-category items, and B-category items to a lesser extent, do not necessarily need to be displayed in an obvious place. It is of importance, on the other hand, to confront the people with the C-category items and, therefore, to put them in highly visible spots. The same can be done with the impulse items. Some items are sold all year long, others are bounded by season. Displays can be used for seasonal items. Displays in general are useful, but they require additional inventory.

Because of the diversity of the products it might be advisable to create "shops" in the store. This concerns especially the C items again. The exterior of your store is no less important. It also should convey a desired image, and consequently attract passers-by. Window displays of C items, including seasonal items, might contribute to the store image. Signage, also, will contribute.

In developing your store design, remember that shelves, bins, racks, hangers, counters and cash registers will all hold in selling merchandise. While new fixtures are always available, often used furnishings and display fixtures are available at significantly lower initial costs. As long as there is no detrimental effect on the overall image created, used fixtures are perfectly suitable.

PERSONNEL

Since personal service is so important, a knowledgeable and personable sales staff is a key element in the selling process. Personalized service is the

most commonly citied reason for continued patronage. Contact with the sales staff is often the only contact a customer has with a store. Personalized service can be the small, independent dealer's marketing advantage over the larger chains and other hardware stores. Since the personnel involved in your store can contribute to its success or failure, it is important to develop hiring policies, carefully screen prospective employers, and train those who are hired. You may find it worthwhile to hire only on a referral basis. Employees should have at least a basic knowledge of customer psychology and selling techiques. Staff should be friendly, courteous and qualified. It is important that employees project a proper image for the store, so they should dress tastefully, in accordance with the store's theme.

It must be emphasized that in most instances the sales staff represent the store to the customer. Sales staff hear complaints, which should be communicated to you, the owner, so that modifications can be made. A competent and courteous sales staff can be your most valuable asset. A lack of the same can be an obstacle between you and the successful operation of your store.

There are several different ways that you might choose to compensate your staff. You might pay on a straight salary or hourly basis, or on commission or a combination of salary and commission.

ADVERTISING AND PROMOTION

Advertising is used to inform the public of your existence and to create interest in your store. There are several ways to determine how much to spend on an advertising budget. The following four methods are perhaps the best known.

(1) Percentage of sales: An amount equal to a set percentage of net sales (say 5%) is spent on advertising.

(2) Comparative parody: The company tries to find out how much money competitors are spending on advertising and then matches that amount.

(3) Affordable method: The firm spends whatever can be afforded.

(4) Objective and task method: An objective (or several) is (are) set for the year's advertising. Objectives may take the form of "Increase gross sales to $300,000 in 198_", "Gain 3 percentage points in market share, to 10% of the market" or "Double current annual sales to customers in the 25-40 year age bracket". Once clear, quantifiable objectives have been set, specific tasks are outlined to fulfill the objectives within a certain period of time.

The last method - objective and task is often the most difficult but may also be the most economical in the long run since it results in an advertising budget that is tailored to one specific business, or even to one business activity, and money is not wasted on unnecessary or unproductive advertising.

The percentage of sales and comparative parody methods are relatively easy but there are draw backs which should be noted. For example, there may exist a saturation level for the industry, and the firm that is not aware of this level may overspend on advertising. There is also a probability of underspending vis-à-vis what the firm could be achieving through advertising. Furthermore, under this method, changes in advertising budget tend to be reactions to current situations rather than results of analysis of the firm's markets.

The affordable method also ignores cause and effect. Since it is based on what the company can afford, current opportunites tend to be overlooked and advertising tends to be viewed as a short-term expense, rather than a long-term investment.

The choice of methods to use in setting advertising budgets is, of course, up to the management of each firm. The most important point is not which method is used but how much thought and analysis go into the final budget.

The key to maximizing the benefit derived from advertising is to properly plan an advertising campaign, gearing it toward your store's target market. Various media can be used to reach your prospective market. Amoung the less expensive means are direct mail, newspaper and radio. The advantage of direct mail is that it is relatively low-priced, and it can be used to reach a specific market area. Direct mail also allows you to develop a high degree of personalization in your messages. Types of newspaper can range from those with provincial exposure to those with emphasis on local events. The greatest disadvantage of newspapers is their short life span, which increases the risk that readers may miss your ad. The radio can be used to make direct contact with specific segments of your market. Each month, radio ratings are published along with audience characteristics and you may be able to target a message to your specific target market. The cost, however, may preclude the use of radio as an advertising medium.

Another promotional method to reach the customer is the "Yellow Pages", which is a virtual "must". To be sure that your advertising dollar is well spent you must determine how much you have budgeted and how many ads you can run by means you have chosen. When the store opens, you will probably need to spend more on advertising than you will later on. Therefore, determine how much you want to spend and fix a schedule for those disbursements. Expenditures on advertising should be highest just prior to the busy season and lower in the slow months.

A useful in-store promotional instrument is the loss-leader. You sell a few products at a low price (at cost or even lower) and these products build traffic and increase sales of other products.

FINANCIAL PLANNING

According to Dun and Bradstreet, the number of small business bankruptcies is increasing, largely because of poor financial planning. The following discussion should help you to systematically plan your short-term and long-term future capital needs. It should enable you to see the need for any additional financing before a crisis arises.

A detailed outline of financial planning is contained in companion volumes in this series - "Small Business Finance Plan", "Service Business Plan", and the "Retail Business Plan". The purpose of this section is to underscore the importance of sound financial planning, by summarizing the basics of the process.

The steps of financial planning include:

(1) determining the cost of the premises, equipment and fixtures
(2) estimating all operating expenses
(3) estimating working capital or cash flow requirements, and the sales volume needed to meet these requirements
(4) preparing projected statements: cash flow, profit and loss, and balance sheet
(5) considering return on investment and comparing with an alternate business investment program
(6) considering the net personal income and balancing this against your personal income needs.

FINANCIAL RECORDS

Decisions made are only as good as the information upon which they are based. Carefully kept records can provide sound information for use in management and financial decision-making. It is not difficult to maintain a record-keeping system sufficient for the needs of most small businesses. The exact requirements vary, depending on the volume of business, the number of suppliers, credit policies, and so on. Some of the records might include:

- A checkbook - you should have a bank account used exclusively for business purposes.
- A cash receipts journal - used to record all payments made to the business and any other cash receipts.
- A cash disbursement journal - used to record all disbursements made by the business. The payment may be for merchandise, wages, rent, utilities, or other such expenses. Payments should be made by cheque, if possible, in order to more effectively control cash.

- An accounts receivable ledger - contains a record of all amounts owed by customers. You may operate strictly on a cash basis, but may also have clients buying on credit. It is advisable to keep track of the credit per client.
- A purchases journal - used to record all purchases made on account.
- An accounts payable ledger - contains a record of all amounts owed to suppliers.
- A payroll journal - to record pertinent data about employees and all wages paid to them.

The record system that you use has to provide information which is relevant to decision-making and is a tool for controlling operations. It gives you insight as to how accurate your financial planning was, what the inventory turnover is, what can be done better, as well as it shows how much your credit policy costs you. Some clients do not pay per transaction but rather they pay monthly or just occasionally. The record system also shows you how much of the inventory is sold and how much just disappeared. Since inventory control is extremely important in the hardware retail business, you could have several records for several inventory categories; this would allow you to identify stock and turnover individually. Your records can be a useful information source and a means of control. You are required to maintain records for taxation purposes, but that should be a secondary consideration in establishing a records system. The most important purpose of keeping financial records is to enable you to monitor the progress of your business.

PRICING

Your pricing strategy has three basic goals:

(1) to cover the original cost of the merchandise
(2) to cover operating expenses
(3) to provide a profit to the store

Retailers generally establish the selling prices of their goods by "marking up" the cost of the merchandise according to some established formula. Markup is expressed as a percentage of the retailer's cost. Thus if you pay $10 for a saw and sell it for $14 the markup is $\frac{\$14 - \$10}{\$10}$ = 40 percent.

A retailer usually follows one of three possible routes for pricing:

(1) pricing above competition
(2) pricing below competition
(3) meeting competitive prices

In a hardware store the prices differ according to category. The A-category items should be priced competitively. The market is clear and the consumer is price-sensitive. The markup is, therefore, low. The B-category items however are non-competitive and can be priced at any reasonable level. The competition does not directly influence the price, so the markup can be as high as 60%, depending on the item. The C-category items must be competitve. The markup differs from one item to the next. Seasonal items have a markup of only 10-20%, but they create traffic. On the average, cost of goods in a hardware store should be about 65-70%. Therefore, the markup would be 30-35%. Remember, this markup must cover all other expenses such as overhead, interest and wages, as well as profit. It is important to have a well balanced product-mix in order to generate both traffic and profits. When goods have been in stock for a considerable time, a retailer will often reduce the price in order to clear some merchandise from the shelves. Such markdowns may indicate changes in market conditions or customer buying habits. Markdowns can also be used as a promotional tool, as sales items can stimulate customer traffic.

SECURITY

Poor security can result in a great many problems, including theft (both internal and external), uncollectable credit and sales, excessive bad cheque losses, etc.

Three groups of people are responsible for most theft:

- salesmen coming into the store
- personnel working in the store
- customers shoplifting

The following suggestions may help you keep these problems to a minimum:

(1) make appointments with salesmen so they do not have to wait in the shop

(2) as manager, be in the store as often as possible

(3) check all work history when hiring new employees

(4) train employees to spot shoplifters, and give them specific procedures to follow should such an incident occur

(5) prosecute all shoplifters apprehended

(6) when taking cheques, carefully examine all identification

Summary

As pointed out, all aspects of the business should be analyzed before starting a hardware store. Decisions whether to buy an existing store or to start a new one, where to locate, whether to be independent or a franchisee, and how to finance the operation, have to be made well before starting the business. When in business, you have to monitor your inventory very closely and critically, keep an eye on your competitors and keep your records up to date.

Financial plans have to be made, evaluated and adapted. You have to train, supervise and motivate your personnel because they can make or break your business. Advertising and other promotional efforts have to be planned and carried out. The store lay-out needs changes regularly, because of seasonal patterns and because it can have a direct effect on sales. Pay special attention to your market because changes in the neighborhood can influence your business, i.e. your assortment, price and level of promotion. Experience and dedication are necessary to be successful in the hardware business.

APPENDIX 1

TABLE 1. Selected operating ratios, in percent of sales, 1987

Manitoba, Hardware Stores (SIC 6531)

	Total(1)	Bottom 25%	Lower middle 25%	Upper middle 25%	Top 25%
Businesses in sample (No.)	58				
Low sales value ($000's)	.(1)	1)	75	277	499
High sales value ($000's)	1)	75	277	499	

Selected expense item	Industry average(2)					% business reporting	Reporting businesses only(3)				
	Total	Bottom 25%	Lower middle 25%	Upper middle 25%	Top 25%		Total	Bottom 25%	Lower middle 25%	Upper middle 25%	Top 25%
	Percent of sales						Percent of sales				
Cost of sales	**60.5**	**47.2**	**65.4**	**63.9**	**61.9**	**92.2**	**65.7**	**63.4**	**65.4**	**71.3**	**61.9**
Occupancy expenses	**4.8**	**9.1**	**4.4**	**3.6**	**3.2**	**100.0**	**4.8**	**9.1**	**4.4**	**3.6**	**3.2**
Depreciation	1.5	4.0	0.8	0.8	0.9	93.2	1.6	4.3	0.8	0.9	1.0
Repairs & maintenance	0.3	0.8	0.1	0.2	0.3	69.9	0.4	1.4	0.2	0.2	0.3
Heat, light & telephone	1.4	2.8	1.0	1.2	0.8	90.8	1.5	2.8	1.5	1.2	0.8
Rent	1.7	1.7	2.5	1.4	1.2	58.6	2.9	3.9	3.5	2.7	1.9
Personnel expenses	**9.5**	**5.4**	**8.3**	**13.0**	**10.4**	**83.4**	**11.4**	**8.6**	**12.4**	**13.0**	**10.4**
Financial expenses	**1.8**	**0.5**	**2.1**	**1.9**	**2.4**	**100.0**	**1.8**	**0.5**	**2.1**	**1.9**	**2.4**
Interest & bank charges	1.4	0.1	1.7	1.4	2.0	94.2	1.5	0.2	1.7	1.6	2.1
Professional fees	0.4	0.3	0.4	0.5	0.4	88.4	0.5	0.4	0.6	0.5	0.4
Other expenses	**15.7**	**18.8**	**10.1**	**15.6**	**19.8**	**100.0**	**15.7**	**18.8**	**10.1**	**15.6**	**19.8**
Profit (loss)	**7.8**	**19.2**	**9.8**	**2.0**	**2.2**	**99.0**	**7.7**	**20.3**	**9.8**	**2.0**	**2.2**
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	...	...	...	...	...

Symbols
- \- zero or no observations
- -- too small too be expressed
- ... not applicable
- x confidential

Footnotes

(1) These estimates are based on a sample of businesses reporting sales between $25,000 and $2,000,000.

(2) Value in each cell = $\frac{\text{Total weighted expenditure on a given item}}{\text{Total weighted sales of all businesses in the sample}} \times 100$ for each quartile.

(3) Value in each cell = $\frac{\text{Total weighted expenditure on a given item}}{\text{Total weighted sales of businesses reporting this item of expenditure}} \times 100$ for each quartile.

This portion of the table pertains only to the businesses reporting the specific expense item. Therefore these ratios are calculated individually and the total will not necessarily equal 100%.

Notes

Data are shown by quartiles when at least 13 of the sampled businesses report the specific item.

Records were ranked in ascending order according to sales size. Each quartile (i.e. bottom 25%, lower middle 25%, etc.) represents one quarter of the total number of businesses. Within each quartile, the average ratio is presented. For comparison purposes, the high and low values of sales are shown.

How to use the tables

(1) Locate the appropriate sales range that is displayed on the two lines entitled "Low sales value" and "High sales value".
(2) The selected range will indicate the proper quartile, i.e. the bottom 25%, the lower middle 25%, the upper middle 25% or the top 25%.
(3) Data pertaining to the selected sales size range will be in that quartile.

Standard Industrial Classification Definition (SIC 1980):

SIC 6531 - Hardware Stores
Businesses primarily engaged in retail dealing in any combination of the basic lines of hardware, such as hand and power tools, builders' hardware, fasteners, electrical and plumbing supplies. These businesses may be secondarily engaged in retailing housewares, electrical appliances, paint, sporting goods, etc. This industry includes retail builders' hardware, retail carpenters' tools, retail electrical supplies, retail fasteners (except clothing), retail furniture and cabinet fittings, retail hand edge tools, hardware stores, retail mechanics' measuring tools, retail mechanics' tools, retail nails, retail plumbing supplies and retail power driven hand tools.

SOURCE: Small Business and Special Surveys Division, Statistics Canada.

APPENDIX 2

TABLE 2. Balance sheet profile for incorporated businesses only, 1987

Manitoba, Hardware Stores (SIC 6531)

	Total(1)	Bottom 25%	Lower middle 25%	Upper middle 25%	Top 25%
Businesses in sample (No.)	34				
Low sales value ($000's)	(1)	--	--	--	--
High sales value ($000's)	(1)	--	--	--	--
		Average $000's:			
Assets					
Cash	-	--	--	--	--
Accounts and notes receivable	22	--	--	--	--
Inventory	-	--	--	--	--
Other current assets	184	--	--	--	--
Total current assets	185	--	--	--	--
Fixed assets	35	--	--	--	--
Less: Accum. dep. on fixed assets	-	--	--	--	--
Other assets	22	--	--	--	--
Total assets	243	--	--	--	--
Liabilities and equity					
Current loans	18	--	--	--	--
Other current liabilities	73	--	--	--	--
Total current liabilities	91	--	--	--	--
Mortgages payable	-	--	--	--	--
Long term debt	14	--	--	--	--
Other liabilities	65	--	--	--	--
Total liabilities	170	--	--	--	--
Total equity	72	--	--	--	--

(1) These estimates are based on a sample of businesses reporting sales between $25,000 and $2,000,000.

See Table 1 for symbols and notes.

TABLE 3. Financial ratios(1) for incorporated businesses only, 1987

Manitoba, Hardware Stores (SIC 6531)

	Total(2)	Bottom 25%	Lower middle 25%	Upper middle 25%	Top 25%
Businesses in sample (No.)	34				
Low sales value ($000's)	(1)	--	--	--	--
High sales value ($000's)	(1)	--	--	--	--
		Average			
Liquidity ratio					
Current ratio (times)	2.0	--	--	--	--
Leverage ratios					
Debt/equity ratio (times)	2.4	--	--	--	--
Interest coverage ratio (times)	2.4	--	--	--	--
Debt ratio (times)	0.7	--	--	--	--

(1) The ratios represent the average of ratios for each business in the group and cannot be calculated from the figures shown in Table 2.

(2) These estimates are based on a sample of businesses reporting sales between $25,000 and $2,000,000.

See Table 1 for symbols and notes.

Definitions:

1. Liquidity ratio:

   Current = current assets / current liabilities.

2. Leverage ratios:

   a) Debt/equity = total liabilities / equity.
   b) Debt ratio = total liabilities / total assets.
   c) Interest coverage = net profit + interest expense / interest expense.

SOURCE: Small Business and Special Surveys Division, Statistics Canada.

APPENDIX 3

TABLE 6. Selected operating characteristics of small businesses by sales quartile, 1985-1987

Manitoba, Hardware Stores (SIC 6531)

	Total	Bottom 25%	Lower middle 25%	Upper middle 25%	Top 25%
			1985		
Number of observations in sample	34				
Average sales $	644.519	--	--	--	--
Average expense $	623.735	--	--	--	--
Average net profit (loss) $	20.783	--	--	--	--
Businesses reporting a profit (No.)	29				
Average sales $	425.821	--	--	--	--
Average expense $	398.384	--	--	--	--
Average net profit $	27.137	--	--	--	--
Businesses reporting a loss (No.)	5				
Average sales $	954.087	--	--	--	--
Average expense $	989.783	--	--	--	--
Average net loss $	-35.716	--	--	--	--
			1986		
Number of observations in sample	105				
Average sales $	252.037	34.930	89.363	191.411	592.443
Average expense $	242.611	32.173	87.131	186.668	564.472
Average net profit (loss) $	9.426	2.757	2.232	4.743	27.971
Businesses reporting a profit (No.)	71				
Average sales $	259.058	35.078	89.650	184.763	726.739
Average expense $	241.835	30.843	81.358	168.452	686.087
Average net profit $	17.223	4.235	7.892	16.311	40.652
Businesses reporting a loss (No.)	34				
Average sales $	218.018	34.480	89.055	201.191	539.384
Average expense $	227.837	36.408	92.676	213.468	567.394
Average net loss $	-11.819	-1.948	-3.621	-12.277	-28.830
			1987		
Number of observations in sample	80				
Average sales $	339.293	48.238	161.388	378.515	758.331
Average expense $	327.472	36.948	143.571	373.017	758.255
Average net profit (loss) $	11.821	11.290	18.317	5.598	12.076
Businesses reporting a profit (No.)	52				
Average sales $	352.452	61.950	160.321	363.525	824.013
Average expense $	330.797	43.348	138.120	347.486	794.232
Average net profit $	21.655	18.602	22.201	16.039	29.781
Businesses reporting a loss (No.)	28				
Average sales $	320.514	25.244	177.110	397.422	682.279
Average expense $	330.663	26.212	194.038	404.838	697.585
Average net loss $	-10.149	-968	-16.928	-7.414	-15.286

(1) These estimates are based on a sample of businesses reporting sales between $25,000 and $2,000,000

See Table 1 for symbols and notes

SOURCE: Small Business and Special Surveys Division, Statistics Canada.

APPENDIX 4

TABLE 4. Statement of changes in financial position for incorporated businesses only, 1987

Manitoba, Hardware Stores (SIC 6531)

	Total (1)	Bottom 25%	Lower middle 25%	Upper middle 25%	Top 25%
Businesses in sample (No.)	9				
Low sales value ($000's)	1	--	--	--	--
High sales value ($000's)	1	--	--	--	--
			Average ($000's)		
Operating activities					
Cash from operations	3	--	--	--	--
Depreciation	5	--	--	--	--
Other	-22	--	--	--	--
Dividends	-3	--	--	--	--
Investment activities					
Disposal of fixed assets	1	--	--	--	--
Purchase of fixed assets	-16	--	--	--	--
Increase in investment	-5	--	--	--	--
Decrease in investment	-	--	--	--	--
Financing activities					
Increase in long term debt	17	--	--	--	--
Repayment of long term debt	-4	--	--	--	--
Loans from shareholders	3	--	--	--	--
Repayment of loans from shareholders	-10	--	--	--	--
Advances & loans from government	-	--	--	--	--
Increase in equity	-	--	--	--	--
Decrease in equity	-	--	--	--	--
Other	-	--	--	--	--
Increase(decrease) in cash & equivalents	-32	--	--	--	--
Cash & equivalents-Beginning of the year	26	--	--	--	--
Cash & equivalents - End of the year	-5	--	--	--	--

(1) These estimates are based on a sample of incorporated businesses reporting sales between $25,000 and $2,000,000. Sample count includes only those businesses reporting a statement of changes.
See Table 1 for symbols and notes.

TABLE 5. Employment changes by size of business, 1984-1987 based on SIC classification in 1987

Manitoba, Hardware,Paint,Glass and Wallpaper Stores (SIC 653)

Business size expressed in average labour units(1)	Number of businesses	Total payroll ($000's)	Average labour units(1)	Changes in number of businesses with paid employees: Newly reporting(2)	Changes in number of businesses with paid employees: No longer reporting(3)
1984					
Total	158	8,877	850	25	12
less than 20	150	5,075	438	24	12
20 - 99	4	x	88	-	-
100 - 499	2	x	126	1	-
500 and over	-	-	-	-	-
1987					
Total	151	8,388	575	17	...
less than 20	147	6,510	472	17	...
20 - 99	4	1,878	107	-	...
100 - 499	-	-	-	-	...
500 and over	-	-	-	-	...

(1) Average labour units are calculated by dividing total payroll by the average annual wage and salary rate as reported in the *Survey of Employment, Payroll and Hours*, Statistics Canada, Catalogue 72-002. An average labour unit could be interpreted as a full-time employee. Note that the business size groups used are determined at the Canada level. Thus if a business has at least 500 employees in Canada as a whole but less than that number in any given province it is shown in the 500 and over group.
(2) Refers to businesses reporting no payroll deductions in the previous year.
(3) Refers to businesses reporting no payroll deductions in the following year.

"Newly reporting" and "no longer reporting" businesses are assumed to have been in activity for six months and the information is adjusted accordingly.

See Table 1 for symbols and notes.

SOURCE: Small Business and Special Surveys Division, Statistics Canada.

PRELIMINARY ESTIMATES

TABLE 10. Retail Trade, Chain and Independent Stores, by Kind of Business

Metropolitan Winnipeg

January - 1988 - Janvier

No.	Kind of business - Genre de commerce	Chain stores - Magasins à succursales		Independent - Magasins indépendants		All stores - Ensemble des magasins	
		Sales - Ventes	Change 1988/1987 Variation	Sales - Ventes	Change 1988/1987 Variation	Sales - Ventes	Change 1988/1987 Variation
		$'000	%	$'000	%	$'000	%
18	Hardware stores	x	x	x	x	909	...

PRELIMINARY ESTIMATES

TABLE 9. Retail Trade, Chain and Independent Stores, by Kind of Business

Manitoba

January - 1988 - Janvier

No.	Kind of business - Genre de commerce	Chain stores - Magasins à succursales		Independent - Magasins indépendants		All stores - Ensemble des magasins	
		Sales - Ventes	Change 1988/1987 Variation	Sales - Ventes	Change 1988/1987 Variation	Sales - Ventes	Change 1988/1987 Variation
		$'000	%	$'000	%	$'000	%
18	Hardware stores	x	x	x	x	3,396	+ 10.9

Source: Statistics Canada CAT#63-005 (Retail Trade)

APPENDIX 6

TABLE B. Analysis of Sales Per Total Area by Kind of Business and Region, Ranked by Sales Per Square Foot of Total Area - Cont'd

TABLEAU B. Analyse des ventes selon la superficie totale d'après le genre de commerce et la région - Classement des ventes par pied carré de superficie totale - suite

Region, Quartiles and Weighted Averages Région, Quartiles et moyennes pondérées	Sales - Ventes: Lower Quartile Values Valeur minimum du quartile		Average Annual Sales	Total Area Average Superficie moyenne de vente		Type of Store Location Genre d'emplacement				
	Square Foot Pieds carrés	Square Metre Mètres carrés	$ 000'S Ventes annuelles moyennes	Square Foot Pieds carrés	Square Metres Mètres carrés	On Street Sur rue	Shopping Centre Neighbourhood de quartier	Community Communautaire	Centre Commercial Regional Régional	Indoor Mall Mail intérieur
	$	$				%	%	%	%	%
	Hardware Stores Quincailleries									
Manitoba										
Top 25% Supérieur 25%.....	139	1,498	1,862	11,000	1,012	100	-	-	-	-
Upper Middle 25% Intermédiaire supérieur 25%.	115	1,238	374	2,984	273	100	-	-	-	-
Lower Middle 25% Intermédiaire inférieur 25%.	38	409	375	4,706	433	100	-	-	-	-
Bottom 25% Inférieur 25%.....			137	5,042	464	100	-	-	-	-
Average Moyenne.....			888	8,000	552	100	-	-	-	-

Source: Statistic Canada Catalogue # 61-522 - 1986 Sales per Selling Area

See Appendix IV for sample counts. Voir l'annexe IV pour les chiffres de l'échantillon.

SOURCE: Retail Selling Area Survey, Small Business Statistics, Statistics Canada
SOURCE: Enquête sur la superficie de vente au detail, Statistiques sur les petites entreprises, Statistique Canada